

Understanding the 3.8% Medicare Surtax

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Background

- The purpose of this presentation is to provide a general background of the tax ramifications as it pertains to the Patient Protection and Affordable Care Act. Two of these provisions – the Medicare Earnings Tax and the Medicare 3.8% Surtax will be implemented starting January, 2013. Johnston Investment Counsel encourages you to seek professional tax guidance to discuss your specific situation.
 - I. Generally speaking, if your Modified Adjusted Gross Income (Adjusted Gross Income with certain adjustments) is below \$200,000 for a single taxpayer and \$250,000 for a married taxpayer, the additional Medicare taxes will not apply.
- Today, the Medicare payroll tax is 1.45% paid by both employees and employers (a total of 2.9%) on an unlimited amount of wages. Starting next year, high-income individuals will pay another 0.9% on their earned income over \$200,000 (single) and \$250,000 (married filing jointly). The employer portion of the tax does not change.
 - I. For example, if a single taxpayer earns \$500,000, he will pay an additional \$2,700 in Medicare taxes during 2013 [(\$500,000 \$-200,000)*0.9%]
- Starting in 2013, high income households (exceeding a certain threshold amount) **may** pay a 3.8% surtax on at least a portion of their investment income, such as capital gains, dividends and rental income.
 - I. The new surtax essentially raises the marginal income tax rate paid by high income taxpayers. A taxpayer in the 39.6% tax bracket (the current highest marginal income tax bracket) would now have a marginal rate of 43.4%.



Overview Of the 3.8% Medicare Surtax

3.8% times the lesser of

1. Net Investment Income

Or

2. The excess of modified adjusted gross income (MAGI) over a threshold amount

Critical Terms

- Net investment income

- Threshold amount
 1. \$200,000 (single taxpayers), \$250,000 (married filing jointly taxpayers), \$11,650 (estates and trusts)

- Modified adjusted gross income (MAGI)
 1. Adjusted gross income (form 1040, line 37) plus net foreign earned income exclusion



Types of Income Subject to Surtax

Subject to Surtax

- Taxable interest
- Dividends
- Annuity income
- Passive royalties
- Rents

Exempt from Surtax

- Wages
- Exempt interest
- Active royalties
- IRA distributions
- 401(k) distributions
- Pension income
- Required minimum distributions
- Social Security income



Examples

Example 1

- Single taxpayer
- \$100,000 of salary
- \$50,000 net investment income
- MAGI is \$150,000

Example 2

- Single taxpayer
- \$0 of salary
- \$225,000 net investment income
- MAGI is \$225,000
- MAGI over threshold by: \$25,000 (\$225,000-\$200,000)

Example 3

- Married filing jointly taxpayer
- \$300,000 combined salary
- \$0 net investment income
- MAGI is \$300,000

Observation

- MAGI is less than threshold amount. Surtax does not apply.

- 3.8% surtax applies to \$25,000

- 3.8% surtax does not apply – wages exempt, no investment income



Examples (continued)

Example 4

- Married filing jointly taxpayer
- \$400,000 of salary
- \$50,000 net investment income
- MAGI is \$450,000

Example 5

- Married filing jointly taxpayer
- \$200,000 of salary
- \$150,000 net investment income
- MAGI is \$350,000
- MAGI over threshold by: \$100,000 (\$350,000-\$250,000)

Example 6

- Single taxpayer
- \$200,000 net investment income
- \$125,000 required minimum distribution from IRA
- MAGI is \$325,000
- MAGI over threshold by: \$125,000 (\$325,000-\$200,000)

Observation

- 3.8% surtax applies to \$50,000

- 3.8% surtax applies to \$100,000

- 3.8% surtax applies to \$125,000



